

The Fitch Ratings logo, with 'Fitch' in red and 'Ratings' in black, is positioned in the top left corner of the white text area. The background of the entire slide features a photograph of a mosque with a large dome and minarets, set against a twilight sky with a crescent moon. The image is overlaid with large, semi-transparent geometric shapes in shades of blue, red, and grey, creating a modern, abstract design.

FitchRatings

Islamic Finance Update: Rating Agency Perspective

Bashar Al-Natoor
Global Head of Islamic Finance

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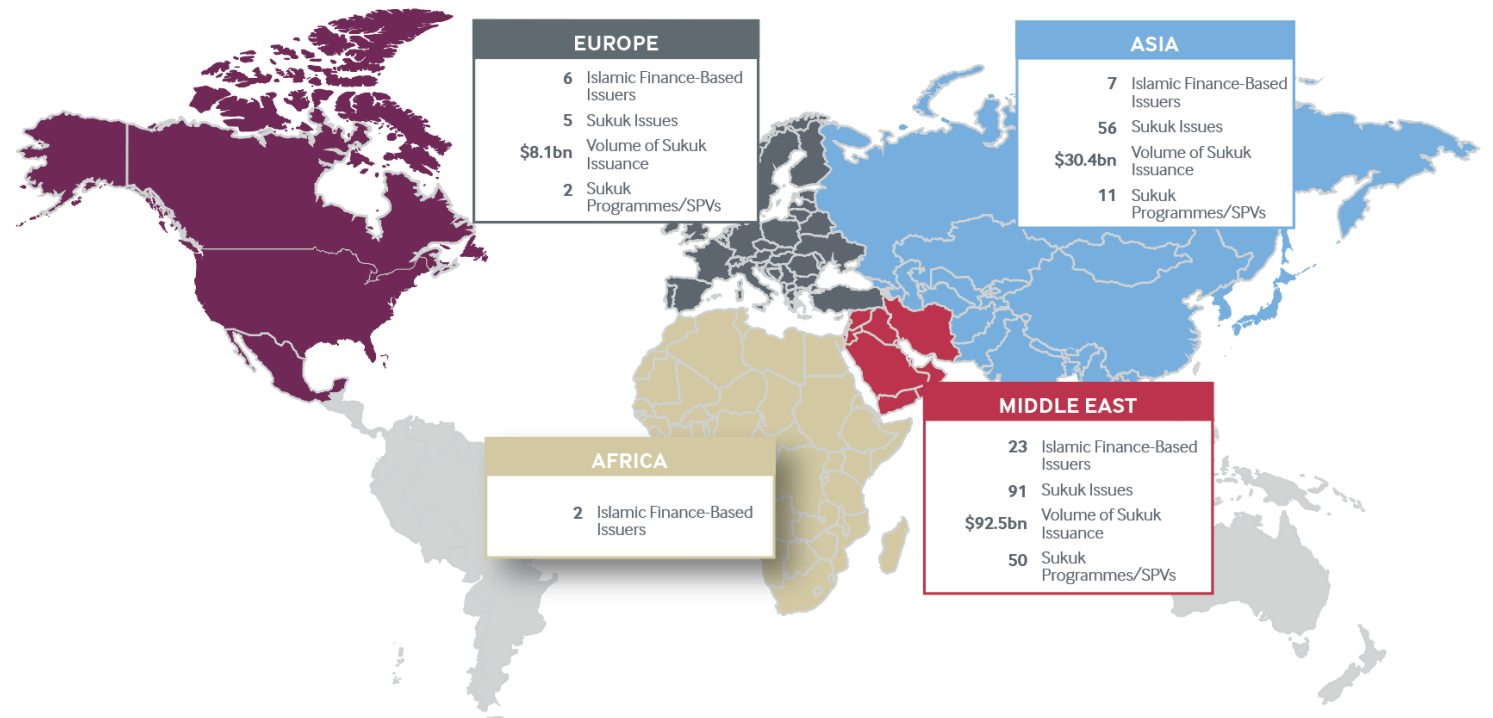
Mapping the Islamic Finance Rating Landscape

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Mapping the Islamic Finance Rating Landscape

- Fitch Ratings has provided independent and objective credit ratings to the Islamic finance market for over a decade
- We rate 164 outstanding Islamic finance instruments (sukuk), 64 sukuk programmes or special-purpose vehicles (SPVs) and 38 Islamic finance issuers (Islamic banks, takaful companies and Islamic corporates) as at end-3Q22

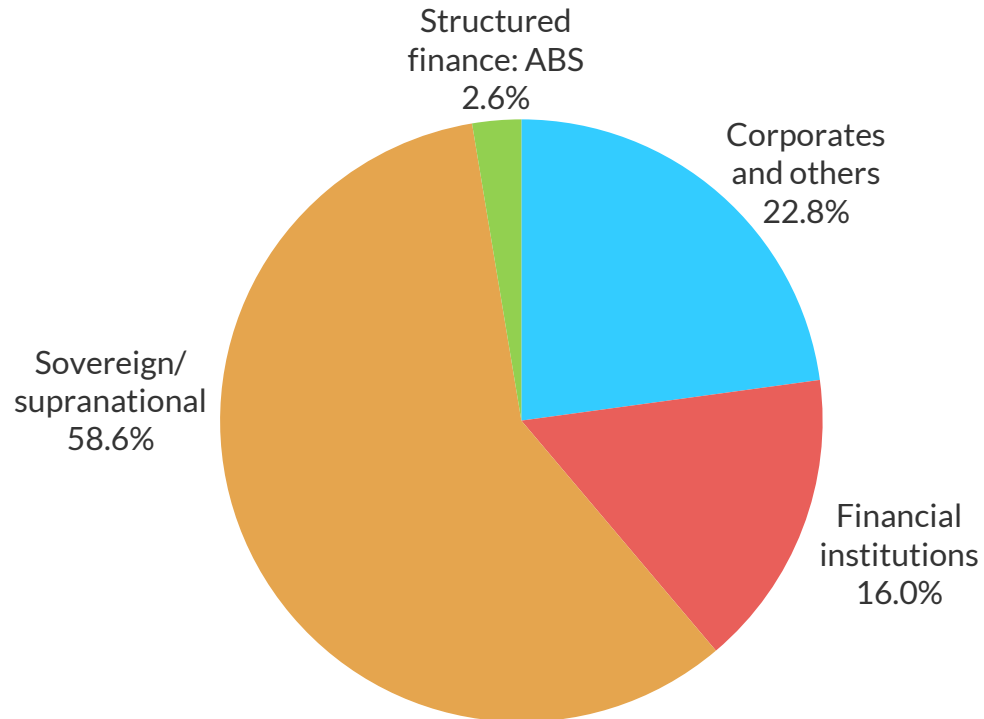
Fitch Ratings' Islamic Finance Coverage



Data as of June 30, 2022
Source: Fitch Ratings

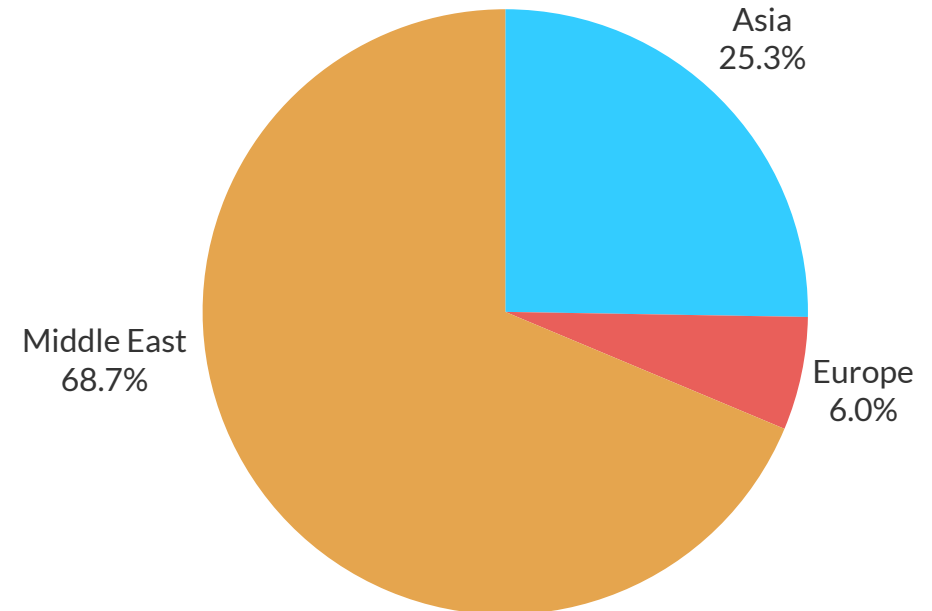
Mapping the Islamic Finance Rating Landscape

Fitch-Rated Outstanding Sukuk Issuance by Volume by Sector: End-3Q22



Source: Fitch Ratings

Fitch-Rated Outstanding Sukuk Issuance by Volume by Region: End-3Q22

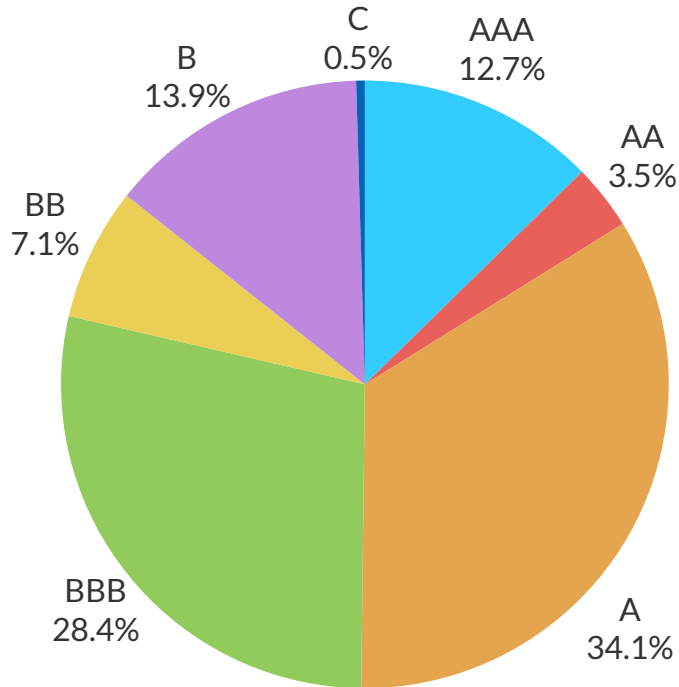


Source: Fitch Ratings

Global Sukuk Ratings Distribution

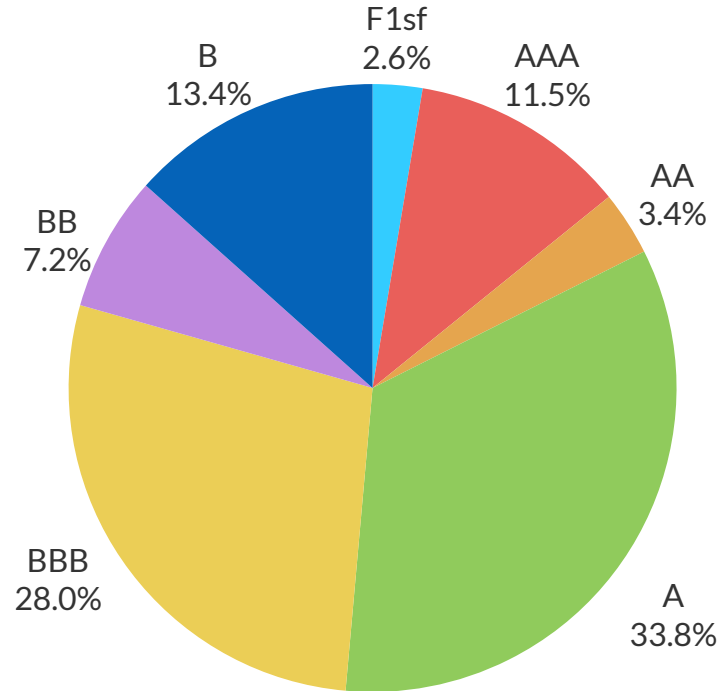
Sovereigns, Supranationals, Financial Institutions and Corporates

2Q22 Ratings Distribution: Fitch-Rated Sukuk^a



^a By outstanding volumes
Source: Fitch Ratings

3Q22 Ratings Distribution: Fitch-Rated Sukuk^a



^a By outstanding volumes
Source: Fitch Ratings

- Investment-grade sukuk issuance made up about 79.0% of total Fitch-rated sukuk in 3Q22 (2Q22: 78.6%). Speculative-grade sukuk contributed the remaining 21.0% (2Q22: 21.4%). Only IDRs were considered
- Sukuk rated in the 'A' category made up 33.6% of rated issuance in 3Q22, followed by sukuk in the 'BBB' and 'B' categories at 27.8% and 13.3%, respectively

Global Sukuk Market Update: 3Q22

Slow Sukuk Market Activity Amid Volatilities; Pipeline Building Up

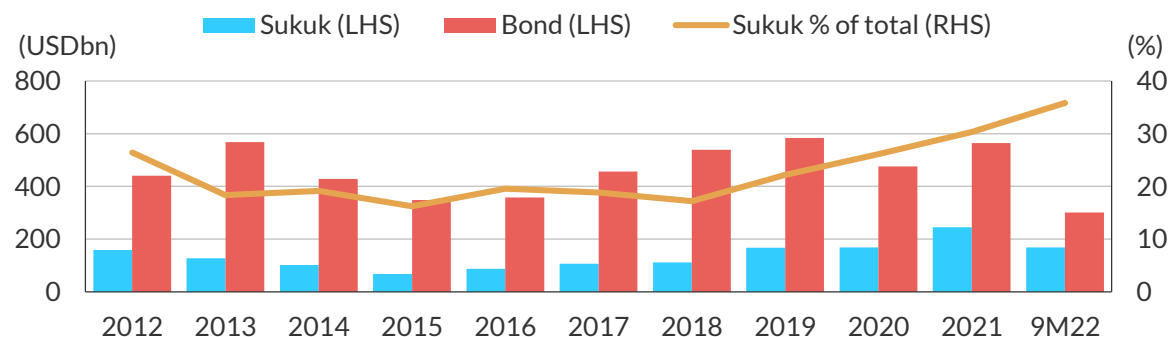
Market Profile: The number of Fitch-rated outstanding sukuk expanded by 7.3% qoq in 3Q22, with outstanding volumes of USD133.9 billion, and 79% being investment-grade. Global outstanding sukuk reached USD749.6 billion, up 2.1% qoq. Total sukuk of USD48.2 billion were issued in the core markets of the GCC, Malaysia, Indonesia, Turkey, and Pakistan (including multilaterals), but was down 14.4% qoq. This is similar to bond issuance in core markets, which fell by 14.1% qoq.

Outstanding sukuk held a 29.5% share in funding mix in core markets (2021: 28.4%). Innovative ESG-related sukuk were up 2.8% qoq, with USD20 billion outstanding in 3Q22. Defaulted sukuk were below 0.3% of total sukuk issuance.

Sovereign Focus: High oil prices are reducing new funding needs for oil-exporting sovereigns, with the GCC countries (excluding Bahrain) expecting to record surpluses in end-2022. Sizeable funding will still be needed in the medium- to long-term to meet the strategies of GCC countries, in addition to refinancing upcoming maturities. Saudi Arabia regularly issues riyal sukuk. In 3Q22, UAE and Bahrain issued US dollar bonds, but not sukuk. Rising interest rates are making funding costly.

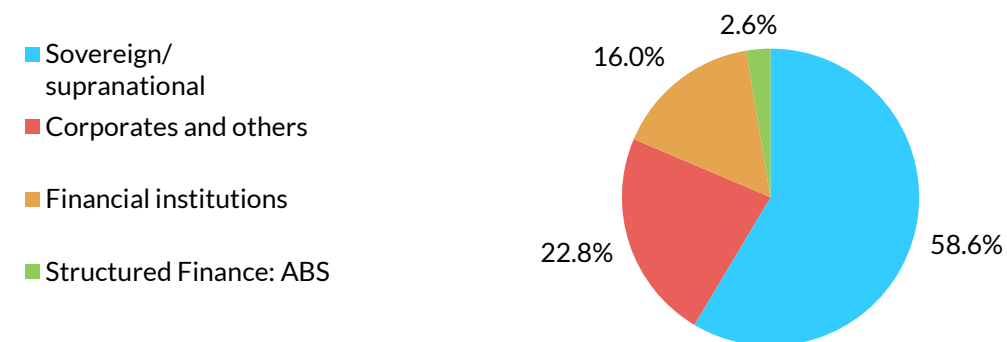
On the other hand, funding needs of oil-importing sovereigns are likely to stay elevated. In 9M22, US dollar sukuk and bonds were issued by Indonesia, Pakistan and Turkey (second sukuk issued in October). The strengthening US dollar has also nudged non-pegged sukuk issuers to raise funding in the domestic market. In 3Q22, 91.6% of all sukuk issued were in local currency, with the balance in hard currency.

Sukuk, Conventional Bonds Issuance in Key Islamic Finance Jurisdictions



Source: Fitch Ratings, Bloomberg

Fitch-Rated Sukuk Volumes by Sector in 3Q22



Source: Fitch Ratings

Global Sukuk Market Update: 3Q22

Slow Sukuk Market Activity Amid Volatilities; Pipeline Building Up

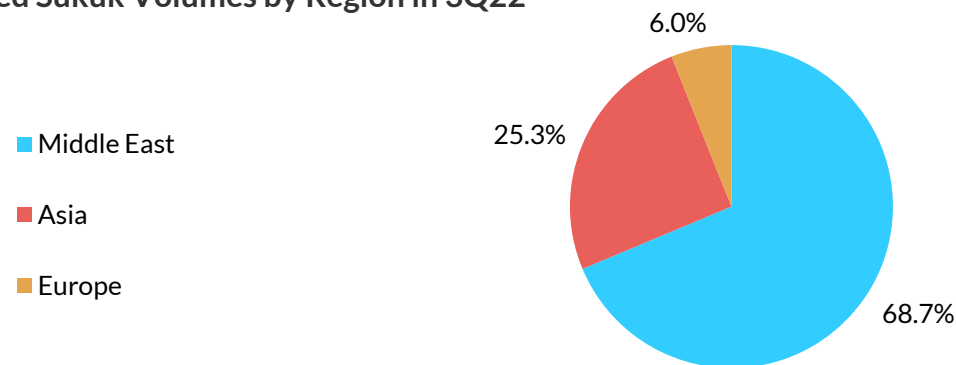
Liquidity Management: Short-term sukuk issued by governments are present in markets such as Malaysia, Indonesia, Bahrain, Qatar, Turkey and Pakistan, along with regular US dollar issuance by International Islamic Liquidity Management 2 SA. This provides Islamic banks a venue to invest their excess liquidity, and help governments manage monetary policy. However, sukuk supply generally dwarfs demand, the liquidity product range and tenor can be expanded, and some sukuk are not tradable due to sharia.

Still-developing markets, such as Oman, Jordan, Nigeria, and Egypt, do not have short-term government sukuk. Domestic Islamic banks are disadvantaged as conventional banks can invest in T-bills.

Outlook: Sukuk pipelines and momentum are building. However, we expect near-term sukuk activity to be generally slow in core markets, similar to bonds. Sukuk are not immune from debt capital market (DCM) volatilities, caused by rising interest rates (2022F/2023F US interest rate: 4%), high oil prices (2022F: USD100 per barrel; 2023F: USD85; 2024F: USD65), geopolitical events and lower emerging-market debt appetite.

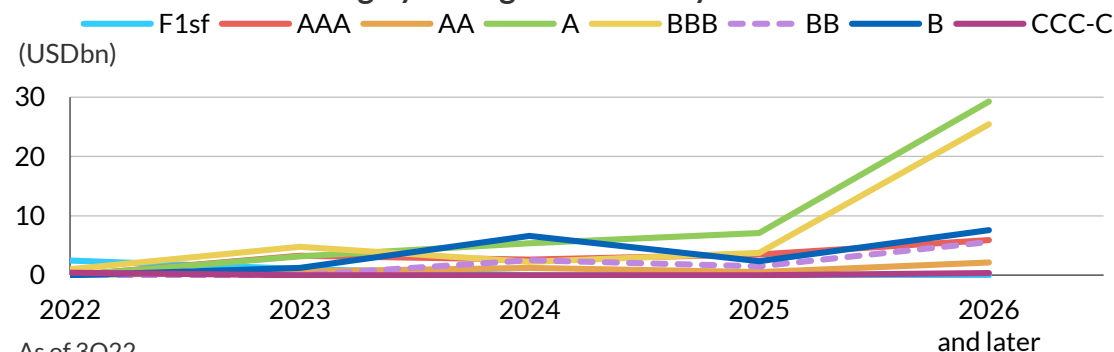
Sukuk demand will stay intact, enabled by its traditional investor – Islamic banks – whose liquidity will be lifted by high oil prices. Sukuk issuance appetite will continue to be driven by funding diversification plans across sectors, upcoming debt maturities, and further maturity of the domestic DCMs in a number of countries.

Fitch-Rated Sukuk Volumes by Region in 3Q22



Source: Fitch Ratings

Total Sukuk Outstanding by Rating and Maturity

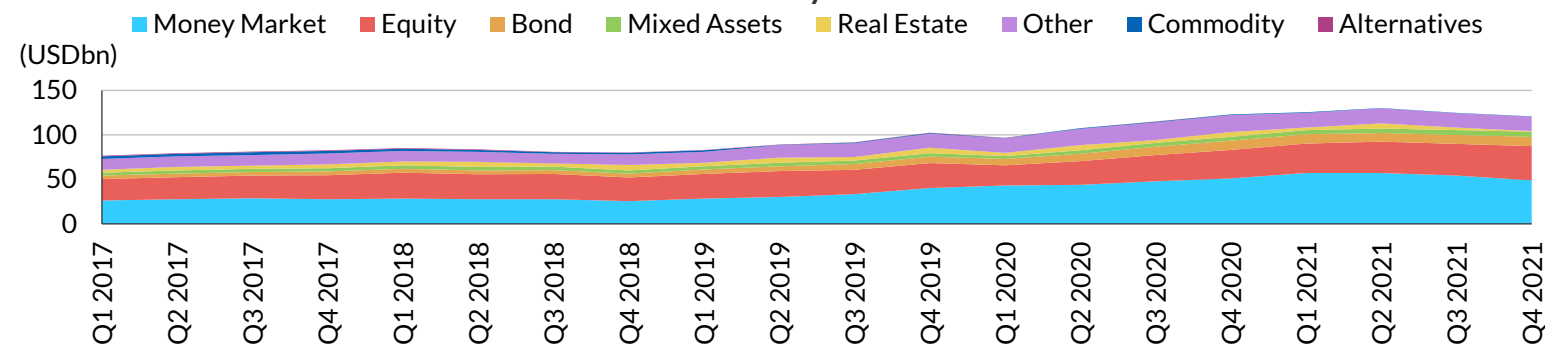


As of 3Q22

Source: Fitch Ratings

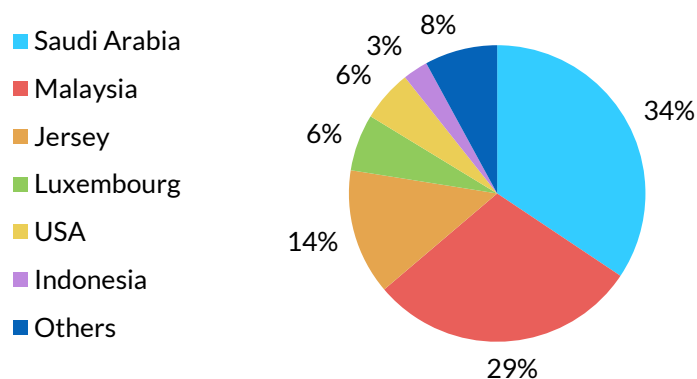
Islamic Fund Industry: A Growth Story

Islamic Mutual Fund Assets Have Increased Substantially



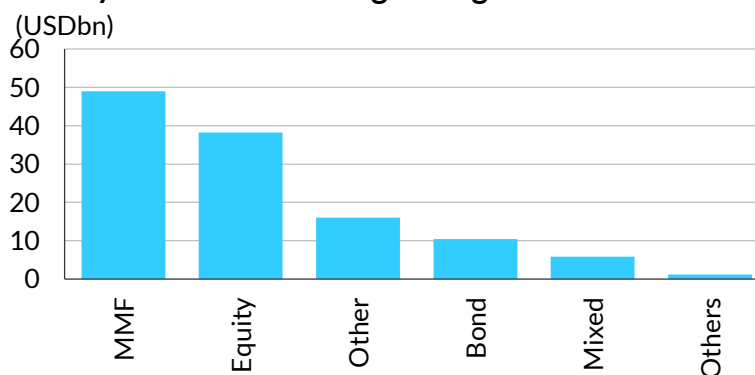
Source: Fitch Ratings, Lipper

Saudia Arabia and Malaysia Dominate



Source: Fitch Ratings, Lipper; 4Q21 USD terms

Money Market Funds Largest Segment



Source: Fitch Ratings, Lipper; 4Q21

- Assets under management (AUM) in Islamic mutual funds have increased substantially, peaking at around USD130 billion at end-2Q21, before slipping to around USD120 billion at end-2021
- Saudi Arabia and Malaysia remain the pre-eminent Islamic fund domiciles worldwide, reflecting strongly established local industries. Offshore markets, such as Jersey and Luxembourg also have nascent Islamic fund markets. Jersey is an Islamic ETF hub, where multiple commodity ETFs (notably gold ETFs) claim Sharia status. Luxembourg has a broader Islamic mutual fund base
- Money market funds (MMFs) are the largest Islamic fund type. This is largely driven by Saudi Arabia being the largest Islamic fund domicile, and by MMFs being the dominant fund type in Saudi Arabia: 83% of Saudi Islamic fund AUM was invested in MMFs at end-4Q21
- Conversely, Malaysian fund assets are more spread out, with the largest segment (equity funds) representing 44% of total AUM



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ESG-Linked Sukuk Market

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Islamic Finance Aligns with ESG Principles

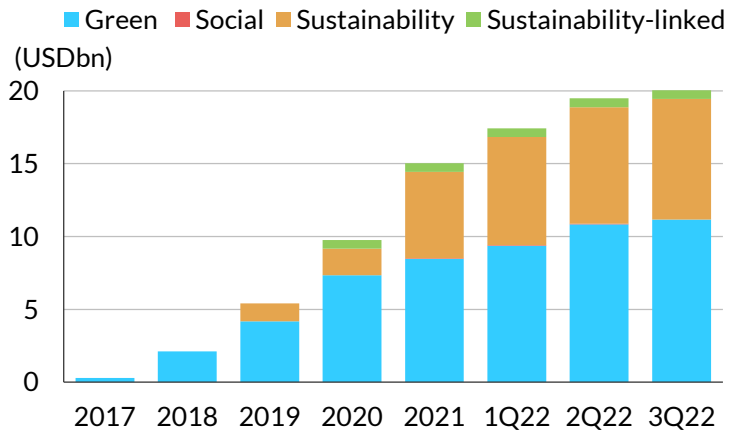
- **Commonalities Between Islamic Finance & ESG Principles:** Commonalities exist between Islamic finance and ESG principles, with both focusing on responsible finance. Islamic finance has embedded in itself core principles that focus on avoiding practices that are harmful, rather than focusing solely on bottom-line profits, similar to ESG principles. However, they are not identical. Islamic finance prohibits income from non-sharia-compliant activities such as alcohol production, tobacco, gambling, pornography, and illegal arms trading. Moreover, Islamic finance does not only relate to the use of proceeds, but Islamic products also have to be structured in a way that complies with sharia.
- **Large ESG Transition Funding Gap in OIC Countries:** Implementing government visions, policies and targets will require significant funding. In 2019, the Islamic Development Bank reported that their 57 member countries [all Organisation of Islamic Cooperation (OIC) countries] needed USD700 billion–USD1 trillion a year to finance Sustainable Development Goals (SDGs), with the funding gap expected to widen further by 2030 on the back of a growing population.
- **ESG Sukuk Fund Sustainability Initiatives:** Supranationals, sovereigns and government-related entities (GREs) in Muslim-majority countries are increasingly funding sustainability initiatives by issuing ESG sukuk. Issuers are also leveraging the rising global investor demand for green, sustainable and social bonds, of which more than USD1 trillion were issued in 2021, 92.8% higher yoy.
- **High Growth Potential:** With the prominence of sukuk and Islamic financing in the core markets of GCC, Malaysia, Indonesia, Turkiye and Pakistan, ESG sukuk issuance is likely to continue growing. The long-term growth potential of the segment remains high, as ESG sukuk make up only about 2.6% of the total sukuk market.



State of ESG-Linked Sukuk Market

- Outlook:** Fitch expects ESG sukuk to remain a key issuance theme in core Islamic finance jurisdictions on back of increasing government initiatives focusing on sustainability and economic diversification, along with rising awareness and sustained investor demand. ESG sukuk makes up 2.6% of global outstanding sukuk, and we expect this share to increase to around 5% over the coming five years. The share of ESG sukuk is also forecasted to reach 15% of all Fitch-rated outstanding sukuk over the medium term
- Market Profile:** Fitch rates more than 80% of the hard-currency ESG-linked or 10.2% of total Fitch-rated sukuk. In 3Q22, outstanding ESG sukuk expanded by 2.9% qoq to reach USD20.04 billion. About USD5.02 billion of ESG sukuk were issued in 9M22. Sovereign and supranational contributed 74.6% of Fitch-rated ESG sukuk, followed by corporates (22.8%) and financial institutions (2.6%)

ESG-Sukuk Outstanding by Year



Source: Fitch Ratings based on Bloomberg-adjusted data

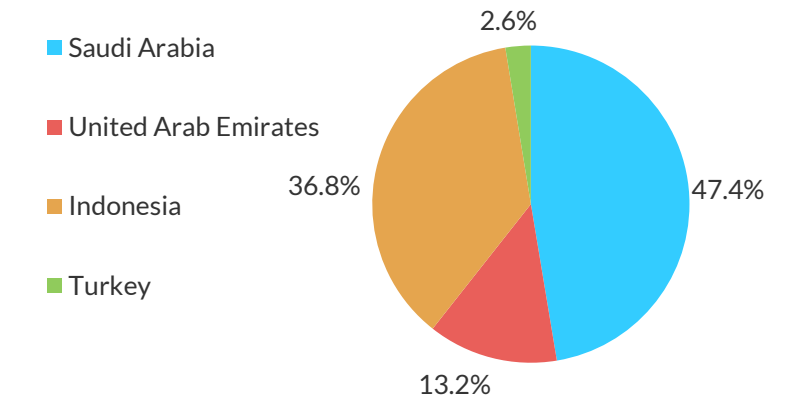
Total ESG Sukuk-Outstanding (3Q22)

	No. of Issuers	Value (USDbn)	% of total ESG sukuk
Green sukuk	150	11.1	55.7%
Sustainability sukuk	44	8.3	41.3%
Sustainability-linked sukuk	1	0.6	3.1%
Social sukuk	0	-	0%
Total	192	20	100

Source: Fitch Ratings

Volume of Fitch-Rated ESG-Linked Sukuk by Region

As at end-3Q22



Source: Fitch Ratings

Sukuk Format Preferred Over Bonds in Many Core Islamic Markets

- Sukuk, rather than conventional bonds, are the preferred format for ESG-related debt in many core Islamic finance markets
- In the GCC region, sukuk were 73.2% of outstanding hard-currency ESG-related debt at end-3Q22, with the balance held in bonds. In Indonesia and Malaysia, the share of sukuk in the hard-currency ESG-debt mix was 58.5% and 40.4%, respectively
- The key driver behind sukuk being the preferred ESG format is to attract the larger Islamic investor base in these countries that have a robust appetite for sukuk and can only invest in sharia-compliant issuances, along with tapping the international investor appetite for ESG products
- There remains a shortage of ESG-focused investors and issuers in the GCC and other core markets

Share of Hard-Currency ESG Sukuk Outstanding (% of hard-currency ESG bonds and sukuk) – 3Q22^a

Country	(%)
Bahrain	100
Saudi Arabia	90.7
Indonesia	58.5
Malaysia	40.4
UAE	36.9
Turkiye	6.5
GCC Countries	73.2

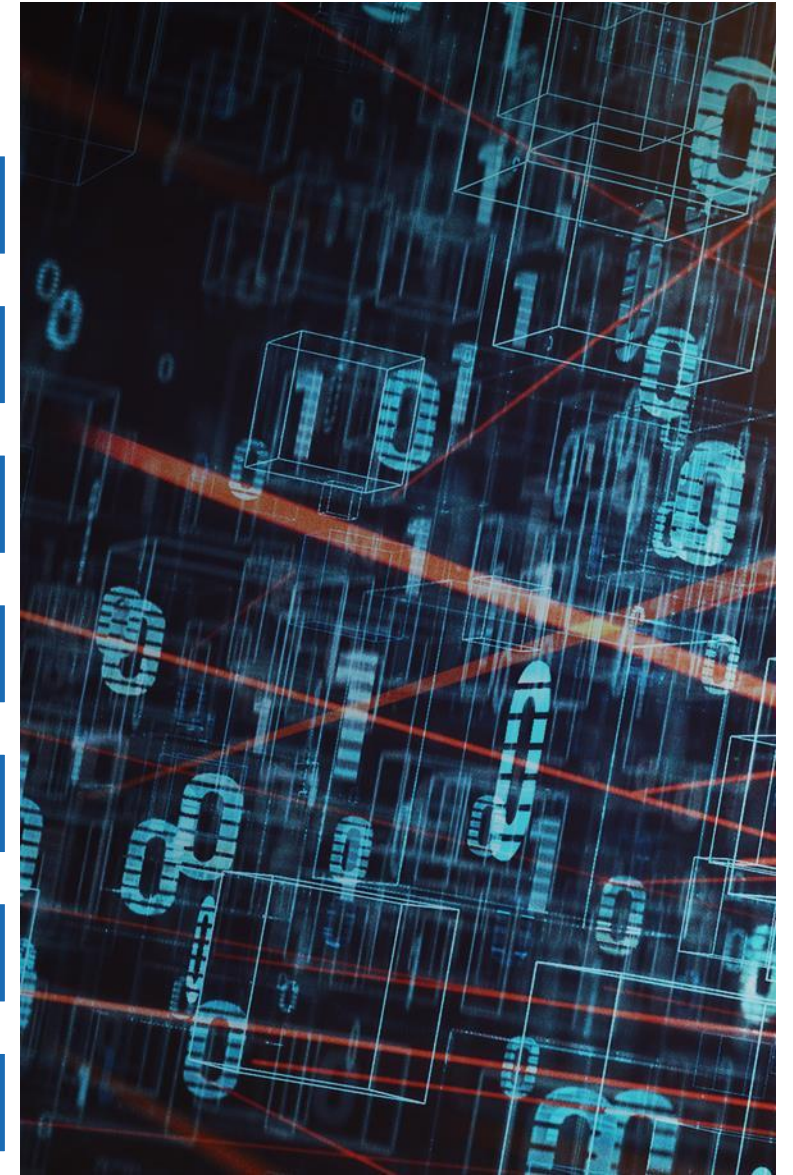
^a Including multilateral banks
Source: Fitch Ratings

Highlights of Key ESG Regulatory Developments in OIC Countries



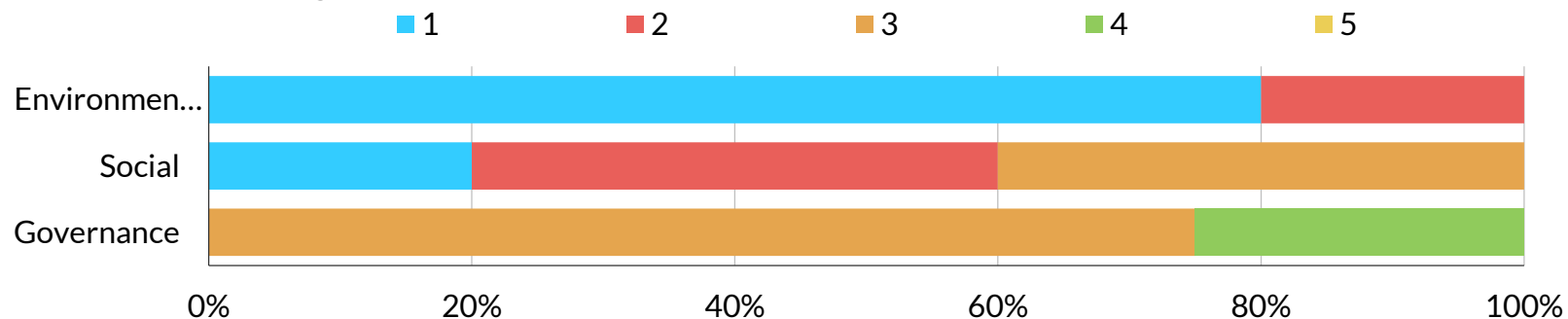
Key Challenges Remain for ESG Sukuk

- Nascent Ecosystem and Regulations, with Progress Uneven Across Jurisdictions
- Shortage of ESG-Focused Investors and Issuers in Core Markets
- Lack of Standardisation Is a Common Challenge for Sukuk and ESG Debt Capital Markets
- Higher Reputation and Legal Risks from Greenwashing
- More Complex Issuance and Longer Time-to-Market
- Human Capital Limitations
- Pricing Advantage Is Uncertain



EMEA Islamic Banks' ESG

ESG Element Scoring Distribution



Source: Fitch Ratings

ESG Scoring Definitions

Lowest Relevance		Neutral	Credit-Relevant to Issuer		
1	2	3	4	5	
Irrelevant to the entity rating and irrelevant to the sector.	Irrelevant to the entity rating but relevant to the sector.	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating.	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors.	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis.	

Islamic banks need to ensure compliance of their entire operations and activities with sharia principles and rules.

- Governance structure relevance score of '4' for rated Islamic banks (in contrast to a typical ESG relevance influence score of '3' for comparable conventional banks)
- ESG relevance score for Exposure to Social Impacts, at a typical score of '3' (versus '2' for comparable conventional banks)



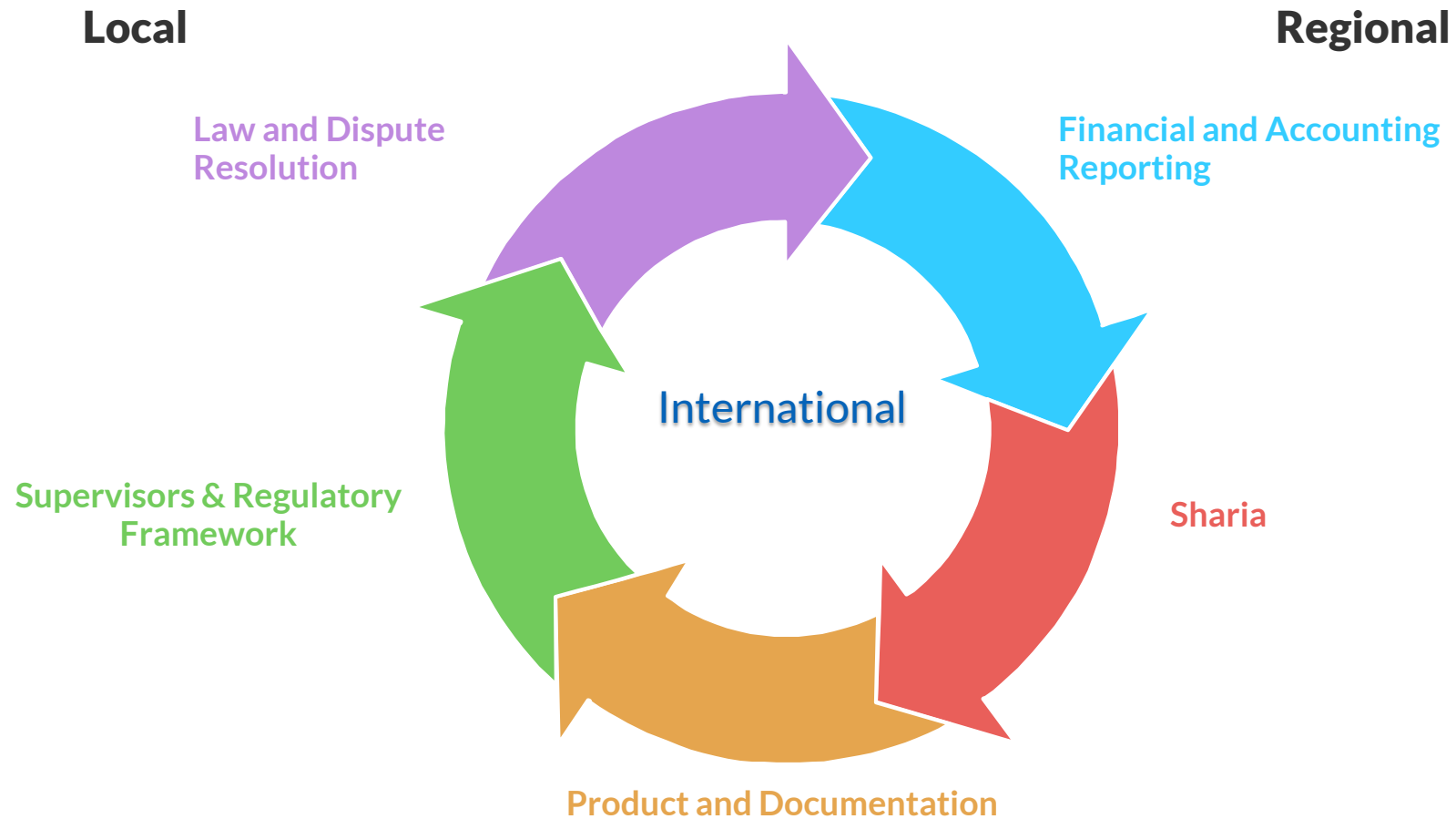
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Standardisation in Islamic Finance

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Islamic Finance Standardisation Framework

Demystifying Islamic Finance Standardisation and Harmonisation



Research: Dedicated Islamic Finance Website

<https://www.fitchratings.com/islamic-finance>

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Global Islamic Finance Industry Landscape

This white paper shares Fitch's outlook and review of the key pillars of the Islamic finance industry: sukuk, Islamic banks, Islamic funds, and takaful.

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Fitch Affirms Dubai Islamic Bank at 'A'; Outlook Stable

THU 27 OCT, 2022
Fitch Affirms Indonesia's Bank Riau Kepri Syariah at 'A(idn)'; Outlook Stable

WED 12 OCT, 2022
Fitch Affirms Indonesia's Bank Kalsel at 'A(idn)/Stable'; Publishes MTNs and Sukuk at 'A(idn)'

FRI 07 OCT, 2022
Fitch Affirms Islamic Bank of Thailand at 'AA(thai)'; Outlook Stable

FRI 30 SEP, 2022
Fitch Affirms Indonesia's BTPN Syariah at 'AAA(idn)'; Outlook Stable

Contact



Bashar Al-Natoor
Global Head of Islamic Finance
bashar.alnatoor@fitchratings.com



fitchratings.com

New York
33 Whitehall Street
New York, NY
10004

London
30 North Colonnade
Canary Wharf
London, E14 5GN

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